Nos. 21,824 and 21,824-A

United States Court of Appeals

For the Ninth Circuit

UNITED STATES OF AMERICA,
Appellant and Cross-Appellee,

vs.

JOE R. RAMOS and MARY RAMOS,
Appellees and Cross-Appellants.

On Appeal from the Judgment of the
United States District Court for the
Northern District of California

REPLY BRIEF OF APPELLANTS-TAXPAYERS TO BRIEF OF UNITED STATES AS CROSS-APPELLEE

and

BRIEF FOR APPELLEES IN REPLY TO BRIEF OF UNITED STATES AS APPELLANT

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QUESTIONS PRESENTED BY TAXPAYERS' APPEAL.

The questions as presented by the taxpayers' appeal have been set forth in taxpayers' brief commencing at page 41 under the heading "QUESTIONS PRESENTED" and contained in Section II of the brief for cross-appellants.

STATUTE AND REGULATIONS INVOLVED.

The pertinent provisions of the statute and regulations involved are contained in Appendix A of the opening brief of the Government.

STATEMENT.

In 1956 the Ramos family partnership included in and reported as part of its gross income the sum of $70,640.48 received for almonds which were raised on taxpayers' ranch and which were subject to an agreement of sale entered into in 1955 prior to the time of the harvest of said crop, but which were delivered to buyers after the creation of the partnership on September 19, 1955. The said partnership was to become operative on January 1, 1956. However, it is to be borne in mind that at the time of the creation of the partnership in September of 1955, it was agreed between the members of the partnership that all money received in 1956 as a result of the "crops business" regardless of whether from the sale of the 1955 crop or otherwise, would be considered as belonging to the partnership business and used as such. In other words, the Rosenberg account receivable was part and parcel of the "crops business" and was part of the assets of the "crops business" transferred to the children at the time of the creation of the 1956 partnership on September 19, 1955. The court below held that the $70,640.48 was taxable to taxpayer-appellants, from which holding taxpayers have appealed. (I.R. 91.)

The Government frankly concedes on page 3 of their reply brief, as follows:

> "The 1956 partnership had the use of taxpayers' land, trees and equipment in the production and harvesting of the crops during that year and paid no rent therefor."

Taxpayers argued below and herein reiterate their contention that the right to the use of lands, trees and equipment, was given to taxpayers' children at the time of the creation of the 1956 partnership, to wit, September 19, 1955. The uncontradicted and undenied testimony is that the children were each given a 25% interest in the "crops business". Neither taxpayers nor taxpayers' children contend that the children received an ownership interest or title to the lands, trees or equipment. The children received this 25% interest in and to the "crops business" as the result of a promise and understanding made by taxpayers to their children many many years before, to wit, that upon Joe S. Ramos attaining the age of 21 years they would be taken into the operation of the "crops business" as partners. The interest in the "crops business" given to the children was undeniably a working interest. The Government has never denied or contradicted taxpayers' contention that the 25% interest in the net proceeds of the 1956 partnership which was paid to Mary Ramos was a share to taxpayers in lieu of rent. Arguendo, if there is any question on this point perhaps it should be remanded for further testimony on this fact. The trial court thus not only erred in failing to credit taxpayers with the receipt of 25% of net profits for the year 1956 as a payment for use of assets retained by taxpayers, but likewise erred in surcharging taxpayers with a 25% of the gross receipts, as and for rent. In determining that taxpayers should be charged with 25% of the gross receipts, the court below further erred in

not recognizing the capital contributions of the children. The trial court did not give the children credit for their capital contributions to the partnership consisting of the 25% interest each in and to the Rosenberg account receivable or the 25% interest each in and to the right of use of the lands, trees and equipment. From the finding that 25% of the gross income of the 1956 partnership should be allocated to taxpayers as rent, both the Government and taxpayers have appealed.

SUMMARY OF ARGUMENT.

1. The Government contends that the $70,640.48 received in 1956 is taxable solely to taxpayers. Taxpayers contend that the said sum was an account receivable in existence at the time of the creation of the 1956 partnership, although the exact dollar and cent amount of said account was indeterminate at that time for the reason that the sales agreement called for a payment on a per pound basis on delivery and the 1955 crop was not delivered until after the formation of the 1956 partnership. Taxpayers further contend that a 50% interest in said account receivable was irrevocably transferred and given to taxpayers' children at the time of the creation of the 1956 partnership and that the interest in the accounts receivable is nothing more or less than an interest in almonds or other assets of the "crops business" and is comparable to the cattle on the hoof which is the subject of a gift to the children in the *Culbertson* case.

2. Taxpayers further argue that even though the sum of $70,640.48 should be found taxable to taxpayers as part of taxpayers' income, that nevertheless, the said sum can be and was the subject of a gift to the children as a part of the gift of the "crops business" at the time of the creation of the partnership, to wit, September 19, 1955, and in turn was a part of the capital contribution of the children to the 1956 partnership.

3. The Government contends that the children contributed no capital or assets and performed little or no services to the 1956 partnership and argues, therefore, that the provisions of the Internal Revenue Code empowering the Commissioner to make a re-allocation of income, are operative. Taxpayers contend that their gift of a 25% interest in and to the "crops business" carried with it all the corresponding interest in and to all the rights, privileges, duties, responsibilities and assets of the "crops business", including the right to their respective shares of the profits, if any, and subjecting the members of the 1956 partnership to their respective share of losses. Taxpayers likewise argue that the 25% interest in the net profits paid to Mary Ramos in 1956 was a payment in lieu of rent and was a payment as and for the right of use of the lands, trees and equipment, and assets retained by taxpayers. Taxpayers further contend that the mere ownership of the documents evidencing legal title to the lands, trees and equipment in and of itself is of little economic value and that it is the *right of use, and use, control and possession of the economic assets of*

*the "crops business"** that is productive of economic values, and that this right is the only capital factor to be considered under the provisions of Section 704 (e)(1) of the 1954 Code, and that under the said Code it is immaterial whether this interest was acquired by purchase or *gift* from other members of the family.

ARGUMENT.

I.

The District Court incorrectly found that the sum of $70,640.48 received in the year 1956 was taxable to taxpayers alone and not to the members of the 1956 partnership.

Taxpayers assert that in the cases cited by the Government in support of its assignment contention, the assignee or donee of the allegedly assigned interest, had the full, free, exclusive and uninterrupted use and control of the assigned interest. In the instant case the Rosenberg account receivable was merely one of the assets belonging to the "crops business", a part of which business was transferred in respective shares to the children on September 19, 1955. It is submitted that the facts in the instant case are very closely the facts and rationale in the case of *Blair v. Commissioner,* 300 U.S. 5. It is interesting to note that throughout the entire proceedings, from the court below to the present time, the Government

*Italics ours throughout unless otherwise noted.

has not at any time pointed to a sum or sums of money given to the particular assignee in such manner that such assignee had the free and exclusive power and dominion over the sum allegedly assigned. The partnership books clearly reflect the receipt and use of the Rosenberg money in its 1956 business operations. This is clearly set forth by the testimony of Joe R. Ramos, as follows:

"Q. At the time that you were talking about the formation of the partnership, or the company that you told us about here—and directing your attention to your son's birthday in September of 1955, his 21st birthday—what was your intention with reference to money that would come in from the balance of the 1955 Rosenberg crop?

A. To use it in '56 as I go along, you know, always do that.

Q. Was it to be used as part of the new company that you were forming?

A. Yes. You need it, as a matter of fact, to run a company anyhow.

Q. Let me ask you this: At the time that you formed this partnership, as you say, with your family, what property did you have to give them? What did you actually give to them?

A. Property?

Q. Yes.

A. I don't give no property to them. *I just give the business,* the crops business but not the property, no.

Q. You gave them an interest in the crops in the business.

A. In the crops in the business." (II-R. 63-64.)

It is likewise of note that the cases cited by the Government in support of its theory of the assignment of an account receivable are for the most part assignments of moneys earned or to be earned from "personal services".

The mere fact that the children received their interest in the "crops business" by gift does not enhance the Government's position that it is an assignment of income. In the case of *United States v. Atkins,* 191 F. 2d 146, the Court held that a father and his emancipated minor son recorded a formal agreement of partnership and the father contributed the partnership holdings in other companies to the partnership by the father and son as capital thereof, such partnership was a bona fide partnership and the income of the partnership distributable to the son was not taxable to the father.

It is likewise here pointed out that the profits distributed to the son and the daughter was in direct proportion to their interest in the capital account of the partnership. There can be no doubt as to the date the children acquired their interest in the "crops business." The uncontradicted testimony of Joe S. Ramos under questioning by the lower court is as follows:

> "The Court: And he said he was going to take you in with him when you were 21?
>
> The Witness: Yes.
>
> The Court: When did you think you were part of the business?
>
> The Witness: When I turned 21, in September." (II-R. 426-427.)

This Court in the case of *United States v. Snow*, 223 F. 2d 103, at page 108, stated as follows:

> "It is now the overwhelming weight of authority and the law of this circuit that an interest in a partnership is a capital asset."

II.

Assuming arguendo that a valid family partnership existed during the year 1956, then (a) the 25% interest each received by the son and daughter must be treated as a capital contribution by the son and daughter to the partnership. (b) The 25% share in the partnership allocated to Mary Ramos must be treated as a further payment as and for the possession, use and enjoyment of partnership assets.

The Government in its reply brief in its footnote 5 at the bottom of page 13 contends in part the following language:

> "*. . . the partnership unquestionably had the use of the assets* and the arbitrary allowance made by the District Court does not adequately reflect the value of such use."

Thus, the Government by its own admission attributes capital value to the right *to use the land, trees and equipment.* The Government contends that the children had received only profits. However, the uncontradicted testimony is otherwise. At page 17 of the Government's reply brief the Government sets forth a portion of the transcript as follows:

> "Q. And this is the type of partnership interest that you had, just in the profits generated by the assets?

A. Profits or losses *that would be produced by the almond trees on the land.*"

The Government apparently takes the position that almonds and profits are showered automatically from some mythical Mt. Olympus. Such is not the case. An almond producing business is a working business. It requires years of training to acquire the necessary skill demanded for successful operation. The many years of training required for their respective jobs were rendered by the children with the oft-repeated assurance that they would be given an interest in the business. Nowhere in the testimony is there any inkling that the children had an interest only in the profits. The Government further states in its footnote 3 at page 9:

> "Nowhere do taxpayers deny that it was their services and capital which created the account receivable during the year 1955."

It is submitted that the testimony of the father is as follows:

> "The Court: May I ask another question?
>
> Your son then helped you with your almond crop for 1955, didn't he?
>
> The Witness: The crop in '55 he helped me.
>
> The Court: He worked the whole crop with you?
>
> The Witness: Yes, sir." (II-R. 26.)

This is further borne out by a comment of the Court, during examination of the son, as follows:

> "The Court: Well, no, I can't say it doesn't bear on the issue, but I think it is pretty well

established that he was really working on that ranch." (II-R. 424.)

While the children knew that the 1955 crop would be harvested and delivered to the buyer in that year, they also knew and were well aware of the fact, from previous like experiences, that a major portion of the crop payment would be paid by the buyer in the following year, in this instance in 1956, and such payment would be after the children received an interest in the "crops business" and also after the partnership commenced its operations. The 1956 partnership was formed before the crop was harvested and delivered. The uncontradicted evidence, as shown, demonstrates that the son worked the entire 1955 crop from June through November. We have also referred to the testimony wherein it was the definite understanding that money received after January 1, 1956, from crop activities would be considered partnership money.

It is pertinent at this point to inquire what reason would the son have to work the 1955 crop when he knew that he was facing imminent military service? The testimony is clear and uncontradicted that he delayed military service until he could complete his work on the 1955 crop. Otherwise, the normal course of events would have dictated that the son would have entered the military service immediately after his graduation from college in June.

It does no violence to the record in this case to state that the children and their parents had the firm understanding and intention that the children were to share

in any moneys received in that portion of the 1955 crop which would be paid for in 1956. Therefore, with this knowledge and understanding, and the attendant background, the Government incorrectly suggests that it was the services and capital alone of taxpayers which created this account receivable.

We submit that the Government has correctly stated the situation when it used the following language in its summary of argument on page 4 of its reply brief, to wit:

> "* * * income from property is taxed to the person who owns *or controls the property* * * *".

The Government goes on and contends that this cannot be defeated by a transfer or assignment to another. The Government does not indicate whether it meant by a transfer of the property, all of the right to use and control the property or of income. Here there was no transfer or assignment of income. There was a transfer by taxpayers to their children of the property right itself. The transfer of the property to the children carried with it the income taxes attributable to the capital assets transferred to the children and the value of this capital asset is to be so treated, the Government having conceded that it has "value." It is interesting to note that the Government has never denied that it was part of the 1956 partnership agreement that in lieu of any rental payment to taxpayer, Mary Ramos would receive a 25% interest in the net profits of the partnership. The matter of partnership rental was not directly raised during the course of

the trial below either by the taxpayers or by the Government. The 25% allocation in 1956 was solely a Court adjustment made after the close of the evidence. The Government in its many years of investigation of these partnerships, was fully aware of this problem. Arguendo, it may be stated that if there is any doubt on this question, the case should be remanded to the District Court for the determination of this issue as well as for the determination of the value of the children's interest in and to the right to use, possession and control of the "crops business" assets. We cannot think of a case or situation in which parents and their children in trying to set up a fair and proper business association, dealt more at "arm's length" than in this situation. In the 1956 partnership the mother received 25% of net profits. In 1957 after further advice on this matter from their certified public accountant, the mother's partnership share of 25% of net profits was eliminated and taxpayers get 25% of gross profits as rent, plus one-third of the net profits.

In closing, we would point out that the Government has never denied that there was a *gift* to the children. The testimony on this point as stated by the father is found at II-R. 64, when in answer to a question he stated:

> "A. I don't give no property to them. I just give the business, the crops business but not the property, no."

Likewise to the same effect is the testimony of Dolores Donaldson, II-R. 156:

"Q. Whose land would the partnership use?
A. We wouldn't own any of the land. We would just use it * * *".

The Government's further contention that allocation must be made because of services, must be viewed in the light of the testimony of the father as recorded in II-R. 104:

"The Court: Did you get paid, too?
The Witness: No, I don't. I tell you why. Because I figure if I work, if I get paid, they can force me to, and this way I just work when I feel like or really they need me bad on the ranch."

CONCLUSION.

For the foregoing reasons that part of the decision of the District Court holding that the sum of $70,640.48 received in 1956 and paid during the 1956 partnership, was taxable solely to taxpayers, should be determined as error. In addition, the Court erred in surcharging the taxpayers with 25% of the gross income of the 1956 partnership, either as rent or by way of allocation.

APPELLEES' REPLY TO BRIEF OF THE UNITED STATES AS APPELLANT

At page 14 of its reply brief, the Government expresses surprise that the taxpayers have stated that the Government openly and frankly has conceded that the evidence supports the findings and that the partnership was in existence for the calendar years 1956 and 1957. There should be no such surprise expressed for the reason we supported the statement by the Government's own statement in its opening brief (page 3): *"The basic facts are virtually undisputed* (I-R. 54)* * *." We maintain that this flat and unequivocal statement warrants appellees' statement. If the basic facts are virtually undisputed and the Court based its findings upon these virtually undisputed facts, we assert that the result is an open and frank concession that the evidence supports the findings and that a family partnership was in existence for the calendar years 1956 and 1957. That the District Court so understood the situation is borne out by the statement in the District Court's Memorandum and Opinions where at pages 5 and 6 it is stated: "The documentary evidence offered and received in evidence, the testimony adduced and the stipulations entered into *show no substantial factual conflict.* The record in these cases presents matters of law arising from what is in practical effect *an agreed statement of facts.*"

The only attack upon the trial court's findings is the naked *assertion* by the Government that the findings that valid family partnerships were in existence

for the calendar years 1956 and 1957 are not supported by the evidence. However, as stated, this is purely an *assertion*. Nowhere throughout the Government's brief is it pointed out *wherein* the findings are unsupported by the evidence or that the findings are against the evidence.

Appellees have pointed out in their brief wherein there is an overwhelming abundance of evidence in support of the findings of fact. We would not go to the length of saying that a substantial part of the Government's appeal is "frivolous and moot" because of its complete failure to point out to this Court wherein in the record there is lack of substantial evidence to sustain the findings. We do, however, earnestly assert and contend that the Government has completely failed to demonstrate wherein the District Court's findings are unsupported.

The Government states (page 15) "As partial support for its contention, the Government, inter alia, contended that neither of the taxpayers' children contributed any capital to the purported 1956 partnership." The Supreme Court in *Commissioner v. Culbertson,* 337 U.S. 733, 93 L. Ed. 1661 squarely held: "The consideration is *not* whether the *services or capital* contributed by a partner are of sufficient importance to meet some *objective* standard supposedly established by the *Tower* case, * * *." The mere fact that neither of the taxpayers' children contributed any money by way of capital to the 1956 partnership, is of no consequence and such lack of contribution did not, per se, defeat the so-called "fam-

ily partnership." The Supreme Court in *Culbertson* has plainly enunciated the factors by which the partnership is to be gauged. These factors are the agreement, the conduct of the parties in execution of its performance, their statements, the testimony of disinterested persons, the relationship of the parties, their respective abilities and capital contributions, the actual control of income and the purposes for which it is used, and any other facts throwing light on their true intent. *The parties in good faith and acting with a business purpose intended to join together in the present conduct of the enterprise.*

It is obvious from *Culbertson* that the test of a family partnership, so-called, is *subjective* rather than *objective.* However, as we have hereinbefore stated, the children did contribute to the partnership capital by transferring their 50% of the *right of use* of the lands, trees and farm equipment.

The Government (page 15 of its reply brief) makes the unsupported statement that the taxpayers were unable to show that the *services* of the children made any substantial contribution to the earnings of the partnership, and have been forced to rely upon a *fabrication* in order to attempt to show that their children contributed *capital* to the partnership. Contrary to the Government's statement, the District Court had ample evidence to support the findings that substantial services were rendered by the children to the 1956 partnership. It was the particular function of the daughter, Dolores, to keep and maintain all of the bookkeeping and accounting records (save and

except the preparation of income tax returns). The fact that these partnership duties did not occupy a majority of her working time, is beside the point and of no consequence. We are unaware of any precept of law requiring a partner to punch in to work on a time clock at nine A.M. and punch out at five P.M. The fact remains that the partnership's accounting records, necessary in the proper conduct of its business, were fully and faithfully prepared and kept by Dolores.

As to the son, Joe S. Ramos, the record is clear that after the formation of the partnership in September 1955 he worked on the ranch until the crop was harvested in November 1955. It was then that he entered military service.

The record is clear and uncontradicted that young Ramos had completed his education, he was 21 years of age, he was unmarried and he had no physical disabilities. He was immediately available for draft into the military service. Faced with this situation, and common with the problem confronting such able-bodied men of his age group, he had to make an election as to whether to continue with his partnership activities, with the present call to service imminent and hanging over his head, or to meet the military situation head-on and discharge his military obligation.

The following pertinent testimony was elicited:

> "The Court: Was there any discussion at any time about holding the partnership up until he got back from the Navy?

The Witness: Oh, no. He was just a partner. If he had to go to the Navy, he had to go, but he was still a partner." (II-R. 157-158.)

Further, it is the uncontradicted record that the son was not unmindful of his partnership status and that he participated in the operation and conduct of the business as best he was able in view of the circumstances which necessitated his absence from the ranch. He was stationed at Hilo on the Island of Hawaii. He was in regular communication by letter correspondence with the members of his family, and in particular with his father and his sister. By means of letter correspondence he gave his counsel and advice and expressed his views as to definite and material matters affecting the successful operation of the partnership farming activities. Also, the uncontradicted record shows that during the occasion of his mother, sister and fiancee visiting the Island of Hawaii where he was stationed, he made known to them his concerns in connection with the partnership activities and discussed with them the various farming problems and partnership activities. Finally, it is a matter of express statute that a partner is not to suffer penalty, or to have his partnership interest jeopardized, because of absence due to military service. (Internal Revenue Code of 1954, Sec. 704(e)(2).)

Appellees have heretofore pointed out at pages 30-31 of their brief, the authorities holding for the rule that where the intent has been established to form a part-

nership, the fact of absence from the partnership as the result of military service is of no consequence.

Culbertson v. C.I.R., 168 F. 2d 979;
Seabrook v. C.I.R., 196 F. 2d 322;
Crossley v. Campbell, 87 F. Supp. 862;
Anderson v. Robinson, 115 F. Supp. 776;
Sklarsky v. U.S., 153 F. Supp. 796.

When taxpayers gave their children an interest in the "crops business" it of necessity included the *use* of the lands, trees and farming machinery. There is no gainsaying the fact that the children acquired, as partners, the sole and exclusive right, together with the mother and father, to the *use* of these items. Likewise, there is no gainsaying that this was anything other than a valuable economic right. We find nothing "strained" in this undeniable fact. The *right of use* was sole and exclusive to the members of the partnership. By conferring this *right of use* to the members of the partnership, the parents, in effect, lost their own sole and exclusive right to the use and possession of the lands, trees and farming equipment. The parents could no longer, as owners deal with any matters concerning the *use and possession* of the property as the same had become circumscribed and limited by their obligations to their children as partners. This *right of use* attached to the property until such time as the partnership would be terminated.

At page 15 the Government cites and relies on the case of *Sellers v. Commissioner,* 218 F. 2d 380. The *Sellers* case is not in point with the instant facts as

found by the District Court. In *Sellers* the Court specifically found against any intention of the Sellers family to form a partnership. *It specifically found that the partnership was not entered into in good faith.* The Court found that the son, Jack, contributed no services, and that the daughter, Virginia, did part-time jobs for the partnership, working about four months in 1944 and two months in 1945. Their written articles of partnership provided that the children would work "only such time as their other interests will reasonably permit." The opinion in *Sellers* further pointed up the fact that the tax court was entitled to *disbelieve* the testimony of the father, mother, daughter and son. In Ramos, the District Court has seen fit to believe and give credence to the testimony of the father, mother, daughter and son. Likewise, in *Sellers* it is pointed out that there are no "disinterested witnesses." In Ramos we have the testimony of the disinterested witnesses, Ruben J. Lopez, Charles H. Huff, Frank R. Molina, Sam Silvey and George W. Franzman. At the time of trial it was stated by Government's counsel: "We have had cumulative testimony as to holding out the partnership. We have had four witnesses so far tending to bear on that. We haven't given a great deal of cross-examination because we think it is fairly truthful * * *." (II. 390-A.) Therefore, the Government has admitted that the testimony of the witnesses, Lopez, Huff, Molina and Silvey is "fairly truthful."

In footnote 6 the Government expresses astonishment at the taxpayers' suggestion that the Govern-

ment did not move for a dismissal "evidently being satisfied that appellees had established their case." The Government then refers to its brief filed with the trial court wherein at page 39 under the heading "Conclusion" it urged that judgment should be entered dismissing the complaints and these actions with prejudice. We would not characterize the concluding prayer of the Government's brief as a motion for a dismissal. What we had, and have, in mind is that at the conclusion of the testimony before the District Court, no formal or other motion for dismissal was made by the Government.

The Government concludes its brief with references to the cases of *Kuney v. Frank,* 308 F. 2d 719 and *Sellers v. Commissioner.* We have heretofore commented on the *Sellers* case. The *Kuney* case is not an authority to be applied in the instant case. In the *Kuney* case it was held that there was no substantial evidence to sustain the verdict holding a family partnership because the parents retained control of the *income* and the donated interests. The facts in Ramos differ sharply. The record is clear and uncontradicted in the instant case that the income paid to the son and daughter by way of partnership profits was beyond the control of the father and the mother and under the sole and complete control and enjoyment of the daughter and the son, respectively. As far as any so-called "donated interests" are concerned, we have specifically pointed out that the parents by giving up their sole and exclusive right to the *use* of the land,

trees and equipment had thereby lost their dominion and control of these properties.

Dated, San Rafael, California,
December 6, 1967.

Respectfully submitted,
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CERTIFICATE

We certify that, in connection with the preparation of this brief, we have examined Rules 18, 19 and 39 of the United States Court of Appeals for the Ninth Circuit, and that, in our opinion, the foregoing brief is in full compliance with those rules.

Dated, San Rafael, California,
December 6, 1967.

JASPER C. DE DOBBELEER,
JEROME A. DUFFY.